

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

UNITED STATES OF AMERICA :
 :
 v. : **CRIMINAL NO. 07 - 156**
 :
 E- STAR, INC. :

GUILTY PLEA MEMORANDUM

I. INTRODUCTION

On March 22, 2007, the United States Attorney filed a criminal information against the defendant, E-Star, Inc., charging the defendant with one count of willfully failing to withhold, account for, and pay over taxes due and owing to the United States of America under the Federal Insurance Contributions Act (“FICA”), in violation of Title 26, United States Code, Section 7202. Specifically, the information charges that the defendant failed to withhold, account for and pay over FICA (i.e., social security) taxes, due and owing to the Internal Revenue Service (“IRS”) for the quarter ending December 31, 2002, in regards to stock bonuses obtained by the employees of the defendant.

The charges arise from the defendant’s participation in a scheme to pay certain employees of the defendant and of other related companies, bonuses in the form of shares of stock of Hon Hai Precision Industry Company, Ltd. (“Hon Hai”), the ultimate parent company of the defendant, without collecting, accounting for or paying over to the IRS, the FICA taxes due upon those employee stock bonuses (“the scheme”).

E-Star, Inc. has informed the United States through its counsel, Ronald H. Levine, Esquire and Brian A. Sun, Esquire, that the corporation intends to enter a guilty plea to the Information. A guilty plea hearing has not been scheduled to date.

II. PLEA AGREEMENT

Defendant E-Star, Inc. has entered into a written plea agreement with the government, pursuant to Rule 11(c)(1)(C) of the Federal Rules of Criminal Procedure. An executed copy of E-Star, Inc.'s plea agreement is attached as Exhibit 1. The terms of the plea agreement are set out below.

Pursuant to Rule 11(c)(1)(C), Fed. R. Crim. P., the parties agree that, subject to this Court's approval, a specific sentence, outlined below, is the appropriate disposition of this case. Should the Court reject the Rule 11(c)(1)(C) plea agreement, the parties have agreed to submit the plea agreement to the Court under Rule 11(c)(1)(B) and ask the Court to consider the agreement under Rule 11(c)(1)(B).¹

E-Star, Inc. agrees to plead guilty to a criminal information charging it with one count of willfully failing to collect, account for and pay over tax to the IRS, in violation of Title 26, United States Code, Section 7202. The parties agree that the following Sentencing Guidelines apply to yield the following specific sentence as the appropriate disposition of the case: (1) the Sentencing Guideline governing this offense is § 2T1.6; (2) the amount of the back taxes due is approximately \$3,464,436; therefore, the defendant's base offense level is 24; (3) under § 8C2.5(a), the base culpability score is 5 and under § 8C2.5(b)(3), because the defendant had 200 or more employees and an individual within high-level personnel participated in, condoned or was wilfully ignorant of the offense, 3 points are added, for an intermediate

¹ Should the Court reject the plea agreement pursuant to Rule 11(C)(1)(c), the government has agreed that it will urge in the strongest possible terms its support for each term of the plea agreement and the civil Closing Agreement referred to in the plea agreement and attached to the plea agreement as Exhibit A.

culpability score of 8; (4) because the defendant clearly demonstrated acceptance of responsibility for its criminal conduct, 1 point is subtracted per § 8C2.5(g)(2), making the final culpability score 7; (5) under § 8C2.6, the fine multiplier is 1.40 to 2.80; (6) under § 8C2.7, the guideline fine range is approximately \$4,850,210 to \$9,700,421, as measured by multiplying the pecuniary loss/gain from the offense by the fine multiplier above; and (7) the Court should sentence the defendant to pay a fine of \$6,928,872, payable on or before the date sentence is imposed by the Court.

The defendant agrees to pay a fine in the amount of \$6,928,872 at or before the time of sentencing. The defendant further agrees to pay the special assessment of \$400 at or before the time of sentencing. The parties incorporate as part of the guilty plea agreement, the civil Closing Agreement which is attached as Exhibit A to the plea agreement. Defendant E-Star agrees that adherence to the Closing Agreement, and payment of any assessment, tax, interest or other payments in this case do not constitute extraordinary acceptance of responsibility or provide any basis to seek a downward departure from the applicable Sentencing Guideline range.

The government agrees that it will bring no other criminal charges arising out of or relating to the scheme charged in the criminal information, against defendant E-Star; the defendant's ultimate parent company, Hon Hai; the parent company of E-Star, Hon Hai Precision Industry Company, Ltd., U.S. Branch ("Hon Hai U.S. branch"); the United States subsidiaries of Hon Hai; or the present or former directors, officers or employees of E-Star, Hon Hai, Hon Hai U.S. branch, or the United States subsidiaries of Hon Hai (the present and former directors, officers and employees of E-Star, Hon Hai, Hon Hai U.S. branch, and the United States subsidiaries of Hon Hai are referred to collectively as "the present and former directors, officers

and employees”). The government’s agreement not to prosecute the present or former directors, officers or employees is contingent upon the filing by those directors, officers and employees who received stock bonuses, of accurate amended federal income tax returns reporting those stock bonuses as income in the years they were received, no later than April 10, 2007, or making arrangements in writing with the Internal Revenue Service to file such returns, as set out in the civil Closing Agreement attached as Exhibit A to the plea agreement.

Finally, the parties agree to ask the Court to find, pursuant to Rule 32(c)(1) of the Federal Rules of Criminal Procedure, that the information in the record is sufficient to enable the Court to meaningfully exercise its sentencing authority and explain its findings on the record without the requirement of a presentence investigation or a presentence investigation report; and sentence the defendant immediately following entry of the guilty plea.

III. MAXIMUM PENALTIES

By pleading guilty to Count 1 of the information, defendant E-Star, Inc. is subject to the following maximum sentence:

Count 1, willfully failing to collect, account for and pay over tax to the IRS, in violation of Title 26, United States Code, Section 7202, a fine of up to twice the gross loss or gain resulting from the offense, five years of probation, and a \$400 special assessment.

IV. ELEMENTS OF THE OFFENSE

A. Count 1 – Failure to Collect, Account For, and Pay Over Tax in violation of 26 U.S.C. § 7202

Section 7202 of Title 26 states in pertinent part:

Any person required under this title to collect, account for, and pay over any tax imposed by this title who willfully fails to collect or truthfully account for and pay over such tax shall, in addition to other penalties provided by law, be guilty of a felony[.]

To establish a violation of Section 7202, the government must prove the following elements beyond a reasonable doubt:

1. A duty to collect, and/or to truthfully account for, and/or pay over specified taxes;
2. Failure to collect, or truthfully account for, or pay over; and
3. Willfulness.

See United States v. Gilbert, 266 F.3d 1180, 1183-85 (9th Cir. 2001); United States v. Thayer, 201 F.3d 214, 219-21 (3d Cir. 1999); United States v. Evangelista, 122 F.3d 112, 120-21 (2d Cir. 1997).

V. SENTENCING GUIDELINES

The Sentencing Guidelines, which are now advisory under United States v. Booker, 543 U.S. 220 (2005), apply to this case. The parties have agreed that the United States Sentencing Guidelines effective November 1, 2005 apply (Exhibit 1, ¶ 7, p. 3). The parties have made Sentencing Guidelines stipulations, outlined below. Under Rule 11(c)(1)(C), the parties agree that application of those stipulations is the appropriate disposition of this case (Exhibit 1, ¶ 7, p. 3). The plea agreement provides that the government will not seek any upward departures under the Sentencing Guidelines, and that the defendant will not seek any downward departures under the Sentencing Guidelines (Exhibit 1, ¶ 9, p. 4).

– The parties agree that the Sentencing Guideline governing this offense is § 2T1.6 (Exhibit 1, ¶ 7 a, p. 3);

– The parties agree that the amount of the back taxes due is approximately \$3,464,436; therefore, the defendant's base offense level is 24. See § 2T4.1(J) (U.S.S.G. effective November 1, 2005)(Exhibit 1, ¶ 7 b, p. 3);

– The parties agree that under § 8C2.5(a), the base culpability score is 5. Under § 8C2.5(b)(3), because the defendant had 200 or more employees and a person within high-level personnel participated in, condoned or was wilfully ignorant of the offense, 3 points are added, for an intermediate culpability score of 8 (Exhibit 1, ¶ 7 c, p. 3);

– The parties agree further that because the defendant clearly demonstrated acceptance of responsibility for its criminal conduct, 1 point is subtracted per § 8C2.5(g)(2), making the final culpability score 7 (Exhibit 1, ¶ 7 d, p. 3);

– The parties agree further that under § 8C2.6, the fine multiplier is 1.40 to 2.80 (Exhibit 1, ¶ 7 e, p. 3);

– The parties agree further that under § 8C2.7, the guideline fine range is approximately \$4,850,210 to \$9,700,421, as measured by multiplying the pecuniary loss/gain from the offense by the fine multiplier above. Section 8C2.4(a)(2) and (a)(3) (Exhibit 1, ¶ 7 f, p. 4).

VI. SUMMARY OF EVIDENCE

At a trial of E-Star, Inc., the government would prove that the defendant participated in a scheme to pay certain employees of the defendant and of other related companies, bonuses in the form of shares of stock of Hon Hai Precision Industry Company, Ltd. (“Hon Hai”), the ultimate parent company of the defendant, without collecting, accounting for or

paying over to the IRS, the social security taxes (“FICA”) due upon those employee stock bonuses, in violation of Title 26, United States Code, Section 7202.

The proof would show that Hon Hai Precision Industry Company Ltd. U.S. Branch (“Hon Hai U.S. branch”) is the United States branch of Hon Hai, a large multinational corporation based in Taiwan, which manufactures computer-related equipment. The stock of Hon Hai is publicly traded in Taiwan, but not in the United States. From 1998 through 2002, Hon Hai had numerous subsidiaries located in the United States, particularly in California, Texas and New Jersey. One such subsidiary, defendant E-Star, Inc., was located at Somerset, New Jersey, and was involved in the overall operation of the manufacture of computer-related equipment.

During the years 1998 through 2002, Hon Hai and its subsidiaries, including defendant E-Star, Inc., issued stock bonuses to many of their employees. Approximately \$99 million in total stock bonuses were awarded and vested during the relevant time period. However, Hon Hai and its subsidiaries, including E-Star, never reported these stock bonuses to the IRS on any annual or quarterly tax returns, or on any reporting form, such as a IRS Form W-2 or, alternatively, an IRS Form 1099. Moreover, the bonuses represented W-2 wages from which defendant E-Star, Inc. and the other companies, as employers, were obligated to withhold social security taxes (FICA), and report on the quarterly payroll tax returns, IRS Forms 941. The corporate employers’ share of the required FICA withholdings, after taking into consideration the fact that the statutory withholding requirement is reduced as wages rise, collectively equals approximately \$3,464,436.

Typically, when a new U.S. employee of defendant E-Star, Inc. or another Hon Hai subsidiary, received a certain salary level or above, that new employee would enter into a compensation agreement under which the employee would receive a certain amount of shares over three years, usually in October, after the completion of at least one year of successful work. For example, an employee hired in 1998 would be told, either orally or in writing, that he or she would receive 5,000 Hon Hai shares in 1999; 3,000 shares in 2000; and 2,000 shares in 2001. The stock awards were actual shares of stock, that is, direct bonuses, rather than stock options. Further, they typically followed the 50% – 30% – 20% disbursement rate over the three years. When the employee finally received his or her first disbursement of shares, he or she would receive a “pink slip:” a pink piece of paper, written in Chinese, listing the amount of shares granted, and when. The value of the shares at any given time would fluctuate based on their price on the Taiwan stock exchange.

When an employee wanted to sell the stock, and thereby realize its value, he or she would, directly or indirectly, email or contact a Hon Hai employee in Taiwan, and request that X shares of stock be sold. The employee also would provide his or her bank account information. The shares would be sold on a foreign exchange. Taiwanese taxes, which generally applied to the par value of the stock and represented a very small percentage of the total sale proceeds, would be withheld. The remaining proceeds then would be wired to the destination of the employee’s choice, usually either a U.S. bank, an overseas bank account, or a relative in Taiwan.

The evidence would show that defendant E-Star, Inc. and the other Hon Hai subsidiaries had a system in place, including a non-automated system of record keeping,

regarding the stock bonus distributions. For years, E-Star and the other companies had a practice of: including a reference to the potential stock bonuses within some (a minority) hiring letters; distributing the “pink slips” to employees regarding their bonuses; creating and obtaining supervisory approval of the stock bonus spread sheets; frequently tying the amount of an employee’s stock bonus grant to his or her employee performance review; and maintaining the system of selling the stock overseas through employees in Taiwan. Thus, the proof would show that the stock bonus program was no accident, and it applied broadly and for many years.

The proof also would show that no later than calendar year 2002, a number of employees of defendant E-Star, Inc. and other Hon Hai subsidiaries had begun asking the management questions about the tax treatment of the stock bonus program. A number of present and past employees of E-Star and other subsidiaries would testify at trial that in 2002 and early 2003, they had asked Hon Hai management whether their stock bonuses had been reported to the IRS, and/or whether United States income taxes had been paid on their stock bonuses. The employees would testify that the answers they received from the companies were inconclusive and confusing. The evidence would show that some of those employees then paid United States income taxes on the stock bonuses, after consulting with their own accountants on the issue.

The accountants for Hon Hai, Price Waterhouse Coopers (“PWC”) also would testify at trial. They would testify that they have worked on the Hon Hai account from 1999 to the present, preparing annual corporate income tax returns for the various companies, as well as providing generalized accounting and financial services. They would testify that no one from defendant E-Star, Inc. or the other companies ever disclosed to PWC that there was a stock bonus program.

The proof would show that the management of defendant E-Star, Inc. and other Hon Hai subsidiaries had knowledge that no taxes ever were collected, reported or paid to the IRS by the defendant or the related companies regarding the stock bonus income. The proof would show further that no later than 2002, management of E-Star and other subsidiaries had been put on notice by the employee inquiries that the stock bonus program violated United States tax laws because no withholdings had been made and no reportings of the stock bonuses had been made to the IRS as required by law. Knowing that the stock bonuses represented income to the employees of E-Star and other Hon Hai subsidiaries, from which E-Star and the other Hon Hai subsidiaries, as employers, were obligated to withhold social security taxes (FICA), and report on the quarterly payroll tax returns, Forms 941, and having been put on notice of the stock bonus programs's illegality, defendant E-Star, Inc. willfully failed to collect and truthfully account for and pay over to the Internal Revenue Service FICA taxes due and owing to the United States of America for the quarter ending December 31, 2002.

The evidence would show that on June 3, 2003, federal search warrants were executed at the offices of certain Hon Hai subsidiaries located in California and Texas. Pursuant to the warrants, the government seized records concerning the stock bonus scheme. After execution of the warrants, a number of high-level officials of various Hon Hai subsidiaries who had received stock bonuses, filed amended individual tax returns for the years 1998 through 2002. The IRS received approximately \$12.9 million in income taxes owing on the stock bonus income reported on those amended returns.

The United States respectfully submits that this summary of evidence provides a factual basis for the guilty plea by E-Star, Inc. to Count 1 of the information.

Respectfully submitted,

PATRICK L. MEEHAN
United States Attorney

MARY E. CRAWLEY
Assistant United States Attorney

PETER D. HARDY
Assistant United States Attorney

CERTIFICATE OF SERVICE

I hereby certify that I have caused to be served a true and correct copy of the annexed Guilty Plea Memorandum on counsel for the defendant E-Star, Inc., by facsimile transmission:

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MARY E. CRAWLEY
Assistant United States Attorney

March 22, 2007